PENSION RIGHTS
CENTER

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Comments for the Committee on Ways and Means
Working Group on Pensions and Retirement
Options for Increased Retirement Security
Submitted by the Pension Rights Center
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Since 1976, the Pension Rights Center has served as the nation's foremost consumer organization working exclusively to protect and promote the retirement rights of workers, retirees, and their families. On their behalf, we appreciate having the opportunity to express our views on retirement savings and tax reforms that would promote retirement security. At a time when middle-income American families are struggling to recover from one of the worst recessions in our nation's history, it is incumbent on Congress to make sure that those who have worked hard and played by the rules are able to retire with adequate income and dignity. This has always been a fundamental shared ideal in this country.

The reason that policymakers have conferred preferential tax treatment on retirement plans is because there is an understanding of just how hard it is for people to save for retirement—particularly for low- and moderate-income workers. These incentives are meant to encourage employers to set up plans and to encourage employees to save. However, the current structure of these incentives end up disproportionately benefitting the nation's most affluent employees, who would almost certainly save for retirement even without tax incentives. For this reason, the Pension Rights Center believes that that, while it is important to preserve tax subsidies for retirement savings, there should be an examination of how they can be better directed to improved retirement solutions aimed at increasing retirement coverage, adequacy and security for low- and moderate-wage earners.

Our statement will discuss three issues:

1. The Retirement Income Deficit facing the country.
2. Tax subsidies -- who is benefitting and who is not benefitting.
3. Incremental and long-term solutions.

1. <u>The Retirement Income Deficit</u>

Without reform, too many people are facing a bleak retirement. For millions of retirees, Social Security payments are not enough to pay for basic necessities, and most of today's retirees have little other income. In fact, Census Bureau data show that income from all sources for one-half of retirees 65 and older is under $16,749 a year. Equally troubling, elderly poverty rates in the U.S. rank among the fifth worst of major industrialized countries.

Future retirees' prospects are even bleaker. One-half of all private-sector workers have no pensions or retirement savings' plan to supplement Social Security—and this has been a stubborn fact for more than a quarter of a century, despite billions of dollars in tax subsidies dedicated toward increasing retirement savings. Too many employers who sponsor pension plans, which provide guaranteed income for life, are freezing, terminating, and otherwise cutting back those plans and replacing them with less-secure 401(k) plans. Thirty years ago, one out of two private-sector workers participated in defined benefit plans. Now that figure is closer to one in five. And 401(k) plans have left most workers with insufficient assets for retirement.

The fact is, while 401(k) plans can work as supplemental savings plans, they do not work well as the primary retirement vehicle for most Americans. 401(k) plans, unlike guaranteed pension plans, put all the risks and responsibilities onto individuals, who must decide whether to participate, how much to contribute, what to invest in, how to resist withdrawing the money before retirement, and finally, figure out how to make the money last. That's a lot to put on someone who is struggling to hold onto a job, pay for escalating health expenses, keep a house afloat, and a family above water.

In 2010, half of all households had less than $44,000 in their accounts. For those approaching retirement, the median account balance was just about $100,000—not nearly enough to last throughout retirement.

There is a massive Retirement Income Deficit facing the nation, an urgent deficit that must be addressed by Congress. According to the nonpartisan Center for Retirement Research at Boston College, the Retirement Income Deficit facing Americans is an astounding $6.6 trillion. That number represents the gap between what people have saved as of today and what they should have saved to achieve a level of sufficiency in retirement. Using a different methodology, McKinsey & Company estimates that if nothing is done, by 2035, "a staggering $27 trillion shortfall will prevent Americans from enjoying a dignified retirement." These numbers will only get worse if Social Security is cut.

2. Tax subsidies: who is benefitting and who is not?

Our country makes an enormous investment, through tax incentives, in employer-provided retirement plans—both 401(k)-type plans and defined benefit plans—as well as Individual Retirement Accounts, which often hold roll-over money when an employee leaves a job. Congress's Joint Committee on Taxation says that these tax incentives will cost about $117 billion in lost revenue to taxpayers this year. According to this measurement, the tax subsidies just for 401(k)s, IRAs, and Keoghs add up to $ 84.3 billion. The Center for Retirement Research calculates that this figure for 401(k) plans, on a present value basis, is between $50-$70 billion. Any way you look at it, that's a lot of money spent when considering that two-thirds of the value of these expensive tax expenditures for retirement savings plans goes to households in the top income quintile, according to the Urban-Brookings Tax Policy Center. These are "upside-down" incentives because they help those who least need help.

While the U.S. Treasury is foregoing billions of dollars every year to encourage retirement saving, the end result is that, despite these expenditures, fewer than half of all Americans are covered by retirement plans, many fail to contribute, and, among those who do, most contribute too little, pay too much in fees, invest poorly, and sometimes withdraw their money before retirement age. While some of these problems can be addressed by automatic features—automatic enrollment and automatic escalation of contributions—the fact is, while such features have merit, they are not a panacea and do not address the structural flaws of 401(k) plans as retirement vehicles. Those most in need of a supplement to Social Security are likely to opt out or contribute too little. And all are vulnerable to market downturns and to wrong guesses when it comes to figuring out how to make their money last through retirement.

3. <u>Solutions to the Retirement Income Deficit</u>

While we recognize there is no single magic bullet to address the major problems in the retirement system, we would like to offer some ideas for this Committee to consider. We will divide our ideas into two buckets: the first is incremental—meaning they can be done now to make existing plans work more efficiently and more equitably; the second bucket is long-term and comprehensive, and includes elements necessary for a secure and adequate system for future generations of retirees.

The Pension Rights Center believes that expanding Social Security would be the most efficient and effective way of strengthening workers' retirement security. But even if Social Security benefits were to be increased, there would still be a need for a stronger, more robust private pension system. As we outline potential solutions, we would like to re-emphasize that this should be a time for re-envisioning the tax system as a means to promote retirement security, not for retrenchment.

Questions of tax fairness, and a growing acknowledgement that 401(k)s are failing millions of Americans have made these plans a prime target for cuts. The annual limit for combined employer and employee 401(k) tax-deferred contributions is currently $51,000 (and that goes up to $56,500 if the contributor is 50 years old or over). The Bowles-Simpson Fiscal Commission report, the Domenici-Rivlin Task Force, and the Bipartisan Policy Center's Debt Reduction Task force all proposed cutting the limit to $20,000 or 20 percent of pay, whichever is lower. This would help pay down the federal deficit but ignores the country's massive Retirement Income Deficit.

From the Pension Rights Center's perspective, a better approach would be for Congress to lower the maximum 401(k) contribution less drastically, perhaps to $35,000—where it was in 2001, the last time the limits were raised—and use the resulting savings as a down payment to help subsidize a range of other retirement solutions, both incremental and comprehensive. Also, Congress might consider measures to trim tax subsidies for people who do not really need incentives to save for retirement, such as the proposal in the President's budget that would suspend contributions to retirement plans and individual retirement accounts for individuals who are on target to accumulate enough assets to fund an annual benefit comparable to the limits imposed on defined benefit plans.

Reforms that could help increase savings in the short-term under existing plans:

- **Expand the Saver's Credit and make it refundable.** The Internal Revenue Code currently includes a Saver's Credit to encourage low- and moderate-income workers to contribute to a 401(k) plan or IRA. However, the credit is quickly phased out, and many low- and moderate-income taxpayers who do not pay income tax fail to qualify for the credit. Others qualify for a credit that is far too small to be much of an incentive to save for people living near the poverty line.

There is a need to make the credit “refundable,” which means that those at the lower-end of the wage spectrum who contribute to a retirement account would actually get a check from the government to put into their account. There should also be consideration of modifying the current phase-out provisions to make the credit a more powerful savings incentive for hard-working, moderate-income taxpayers. These ideas were generally endorsed by the Conversation on Coverage, a seven-year common-ground dialogue convened by the Pension Rights Center involving businesses, unions, financial institutions, consumer, and retiree groups.

- **Enable reverse-match SEPs.** SEPS—or Simplified Employee Pensions—are the simplest of all pension plans. The maximum contribution to SEPs is $51,000 or 25 percent of pay, whichever is less. Under the Model IRS SEP, employers make contributions based on the same percentage of pay for all eligible employees. However, employees cannot add to those contributions.

  The Pension Rights Center believes Congress should allow for a reverse match salary deferral option. This would allow employees to match employer contributions on a 2:1 tax deferred basis, as long as the total doesn’t exceed current contribution limits. This would go a long way to enabling employees in these straightforward employer-sponsored plans to achieve a higher level of adequacy in retirement.

- **Provide incentives for defined benefit plans.** While some experts write off defined benefit plans as “dinosaurs,” there are still millions of employees participating in these plans, and there are good reasons to find ways to preserve and encourage them. In defined benefit plans, employees are automatically enrolled, they do not have to make investment decisions, and the benefits are generally paid out at retirement as annuities that the employee and spouse cannot outlive. Employees bear neither investment nor mortality risk. Yet employers today prefer 401(k) plans because they are less expensive to fund and operate, and because they avoid contribution volatility due to market and interest rate fluctuations.

  The Conversation on Coverage developed a new type of simplified pension plan, the Plain Old Pension Plan, which could minimize funding volatility, and, thus, be attractive to both employers and employees. These types of plans should be encouraged, but there are rules under current law that would have to be changed to make them feasible. The Internal Revenue Code could also be designed to provide targeted tax incentives for small employers to adopt and maintain these simplified defined benefit plans. These ideas should also be discussed.

- **Limit leakage through tax reform.** One of the most serious and intractable retirement-savings problems for 401(k) plans and IRAs has been leakage: people withdraw the money in their retirement accounts before retirement. Under current law, experts are almost unanimous in identifying leakage as one of the most serious problems for low- and middle-income workers. Yet the main tax provision to control leakage is a 10 percent additional income tax on certain pre-retirement use of retirement savings, which has served primarily as a steep additional tax on the poor and the middle-class, while doing little to actually control the problem.

Thoughtful tax reform, however, can be used as a potent weapon against leakage. Congress could create voluntarily designated 401(k)s and IRAs that once designated could not be accessed prior to retirement—and use carefully targeted tax incentives directed at both employees and employers to encourage the use of such “lock-down” accounts. Moreover, the Saver’s Credit itself might be locked down so that that the credit amount is not available until retirement. The design blueprint and rules for such accounts, and the creation of effective tax incentives for them, would present various challenges, but we think they are challenges worth undertaking.

- **Encourage options to encourage annuitization.** Participants in defined contribution plans generally are not offered the option of taking their benefits in annuity form and then find it difficult to both invest and systematically draw down their savings in retirement. But Congress should consider ways to encourage plans to offer annuity and partial annuity options, including annuities that commence at later ages, and ways to encourage participants to give serious consideration to such options

- **Create an Office of Participant Advocate within the Internal Revenue Service to represent the concerns of retirement plan participants and beneficiaries.** The IRS is charged with interpreting and administering all of the provisions of ERISA and the Internal Revenue Code that relate to who is entitled to benefits and how and when those benefits are paid. However, its focus is only on ensuring that taxpayers—namely plan sponsors—follow the rules so as to ensure that the Treasury receives all of the revenue that Congress has authorized it to collect. For this reason, the IRS takes the position that it cannot talk to participants and beneficiaries about their specific concerns since, in the retirement plan context, they are not taxpayers. They also cannot receive formal rulings on individual matters but are limited to General Information Letters. Finally, there is also no internal mechanism for their concerns to be factored into informal deliberations within the IRS.

  The IRS currently has an Office of Taxpayer Advocate which serves as an Ombudsman’s Office to address the concerns of individuals in income, trust, and estate matters. A similar office should be established to address retirement income concerns.

Envisioning a better system

The Pension Rights Center, while examining short-term reforms, also is spurring a more comprehensive debate to envision a better system for future generations. The fact is that regardless of the amount of tax incentives provided to employees and employers, the end result is that coverage is still too low, people have not saved adequately, and benefits are not secure.

For this reason, the Center also believes that, while working to improve the current system, we should also begin to consider a new system on top of Social Security that covers everyone and that provides adequate and secure income. The question is, with the amount of money we are now spending now to encourage retirement savings, can we do better and create a system that ensures that all Americans can retire with adequate income?

To that end, the Center, along with unions, retiree groups, and think tanks, started Retirement USA to promote the need for a new universal, secure, and adequate retirement system on top of Social Security. We developed 12 principles that we think should underlie a new system and that borrow from the best parts of defined benefit plans and 401(k) plans. As a starting point, we all believe that any new private retirement savings program must build on top of an unreduced Social Security system. Social Security must be maintained and strengthened, because it is doing an unparalleled job of providing a basic foundation of income for retirees.

The key principles for a new system are:

- Universal Coverage. Every worker should be covered by a retirement plan. A new retirement system that supplements Social Security should include all workers, unless they already are in plans that provide equally secure and adequate benefits.
- Secure Retirement. Retirement shouldn't be a gamble. Workers should be able to count on a steady lifetime stream of retirement income to supplement Social Security.
- Adequate Income. Everyone should be able to have an adequate retirement income after a lifetime of work. The average worker should have sufficient income, together with Social Security, to maintain a reasonable standard of living in retirement.

Sub-principles for a new retirement system include shared responsibility—employers and employees should both contribute and the government should subsidize the contributions of lower-income workers. We also believe that pooled, professionally managed assets are key to a secure retirement, that there should be no leakage, and benefits should be paid as a lifetime annuities.

These are not unreachable ideals, and there are many plans and proposals that we have looked to in developing our principles and ideas for a new system, both here and abroad. For instance, TIAA-CREF, the plan for academics and educators, has employer contributions, uses pooled investments, and pays out benefits as lifetime annuities. The Guaranteed Retirement Account, developed by Professor Teresa Ghilarducci and the Economic Policy Institute, requires shared contributions by employees and employers into accounts that would guarantee a minimum rate of return and benefits paid out as annuities. The ERISA Industry Committee has proposed a plan in which contributions would be pooled and professionally invested, there would be no leakage, and benefits would be paid as annuities. And, if we look to other countries, the Netherlands has an interesting model in which employees' savings are pooled and there is shared risk among employees and retirees—rather than all of the risks being borne by individuals or employers.

The Pension Rights Center has proposed a new kind of plan called Retirement Security Funds, which require new kinds of pooled single-purpose funds, employees and employers to both contribute with a reverse match, and shared longevity and investment risk.

Many of these concepts are gaining traction, not just among participant-oriented groups but among employers as well, because there is a growing consensus that we must both improve what exists—by preserving today's DB plans and improving 401(k) plans—and also by developing new kinds of plans that better serve tomorrow's retirees.

We urge the Committee to work to fix the current system to the extent possible, but to also recognize the shortcomings of what we have and work toward better solutions. To achieve a system that works for all workers and retirees, it is imperative that we deploy our tax system and other mechanisms to meet the challenges of confronting current and future retirees.